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10 UNITED STATES DISTRICT COURT  
11 NORTHERN DISTRICT OF CALIFORNIA  
12 SAN JOSE DIVISION  
13

14 JAMES RAFTON, TRUSTEE OF THE  
15 JAMES AND CYNTHIA RAFTON  
TRUST,

16 Plaintiff,

17 v.  
18

19 RYDEX SERIES FUNDS; PADCO  
ADVISORS INC. d/b/a RYDEX  
20 INVESTMENTS, INC.; RYDEX  
DISTRIBUTORS, INC.; RICHARD M.  
GOLDMAN; CARL G.  
21 VERBONCOEUR; JOHN O. DEMARET;  
NICK BONOS; MICHAEL P. BYRUM;  
22 COREY A. COLEHOUR; J. KENNETH  
DALTON; WERNER E. KELLER;  
23 THOMAS F. LYDON; PATRICK T.  
MCCARVILLE; ROGER SOMERS; and  
24 DOES 1 through 25, inclusive,

25 Defendants.  
26  
27  
28

Case No. 10cv1171 LHK

**INDEPENDENT TRUSTEES' REPLY  
MEMORANDUM OF POINTS AND  
AUTHORITIES IN SUPPORT OF  
MOTION TO DISMISS PLAINTIFFS'  
FIRST AMENDED CLASS ACTION  
COMPLAINT**

Date: December 16, 2010

Time: 1:30 p.m.

Dept.: Courtroom 4, 5th Floor

Judge: The Hon. Lucy H. Koh

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**STATEMENT OF FACTS AND ISSUES (Local Rule 7-4(a))**

The Independent Trustees incorporate by reference the statements of facts, statements of the issues, and arguments set forth in the Independent Trustees' opening brief ("Independent Trustees' MTD") and in the Rydex Defendants' opening and reply briefs as if fully set forth in this Memorandum.

**ARGUMENT AND CITATION OF AUTHORITY**

**I. PRELIMINARY STATEMENT**

As set forth more fully in the Rydex Defendants' reply brief, which the Independent Trustees incorporate to avoid duplication, Plaintiffs' First Amended Class Action Complaint ("Complaint") should be dismissed on the merits because the Fund's public disclosures on their face make clear that the Fund's objective was to match the inverse of the price movement of the Long Treasury Bond on a daily basis, not over time. Plaintiffs apparently believe that the disclosures were incomplete or misleading because they did not also warn investors that the Fund's returns would not necessarily correlate with the inverse of the cumulative price movements of the Long Treasury Bond over time. Of course, as the Rydex Defendants' Reply points out, the disclosures actually did contain such statements, both in words and in pictures. But even if they had not, it simply does not make sense to assert that a fund violates the Securities Act of 1933 ("Securities Act") unless it discloses what its investment objective is not. Plaintiffs would have the Court hold that when a prospectus says "it is day," it is misleading unless it also says "it is not night." They have not cited a single case for that illogical proposition.

Merits aside, Plaintiffs cannot reasonably dispute that they were on notice of their claims more than a year before they filed suit, which means their claims are barred. The Registration Statements and Prospectuses thoroughly disclosed the compounding effect and the Fund's objective of correlating with the price of the Long Treasury Bond on a daily basis. Moreover, charts in Annual Reports showed that a buy-and-hold strategy for the Fund's shares had not been, and likely would not be, consistent with the Fund's objective to daily match the inverse of the price movement of the Long Treasury Bond. Plaintiffs say the charts did not constitute legal notice because they were just too complicated. But some of the charts were color pictures, the

1 import of which was unmistakable and would have been obvious to a reasonable investor: over a  
 2 sustained period, the price of the Fund's shares and the price of the Long Treasury Bond had  
 3 moved in the same way and not inverse to each other. That graphic depiction, along with several  
 4 widely available articles containing similar information, would have put any reasonable investor  
 5 on notice that "daily" means "daily" and if you want to buy and hold, you should do so with care.

6 Plaintiffs' arguments to remedy the absence of loss causation are also without merit.  
 7 First, they rely on a recent case that improperly applied the broader concept of loss causation  
 8 under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") to Sections 11 and  
 9 12 of the Securities Act. The plain language of the Securities Act, which controls here, is  
 10 inconsistent with that approach. Second, Plaintiffs try to twist an allegation of transaction  
 11 causation into one of loss causation, asserting that investors may have been confused by certain  
 12 disclosure language. Even as alleged, this would be garden-variety transaction causation but  
 13 certainly would not establish loss causation.

14 Next, the Plaintiffs' control-person argument against the Independent Trustees is not  
 15 drawn from the concededly meager allegations in the Complaint, but from information found  
 16 elsewhere regarding the Trustees' activities as a group. While the Complaint's failure properly to  
 17 allege control is basis enough for dismissal, even the other "facts" Plaintiffs identify outside the  
 18 Complaint do not come close to meeting the essential elements of control-person liability.

19 Finally, Plaintiffs stretch too far in asserting standing to represent purchasers of Fund  
 20 shares issued pursuant to a 2009 Prospectus they never could have purchased under and in share  
 21 classes they never bought. Standing is a jurisdictional prerequisite the Court may not treat as  
 22 dismissively as Plaintiffs urge.

23 **II. PLAINTIFFS' CLAIMS ARE TIME-BARRED, BECAUSE THEY HAD NOTICE**  
 24 **OF THE FACTS UNDERLYING THEIR CLAIMS.**

25 Plaintiffs ask the Court to decide whether the notice they had was sufficient to commence  
 26 the running of the statute of limitations based upon *Betz v. Trainer Wortham & Co.*, 519 F.3d 863  
 27 (9th Cir. 2008), asserting that *Betz* is "settled Ninth Circuit law." Opp. at 3. *Betz* was decided  
 28

1 under the Exchange Act, not the Securities Act, and, in any event, has been vacated by the  
 2 Supreme Court and remanded for further consideration in light of *Merck v. Reynolds*, 130 S. Ct.  
 3 1784 (2010).<sup>1</sup>

4 Claims brought under Sections 11 and 12(a)(2) of the Securities Act must be brought  
 5 “within one year after the discovery of the untrue statement or omission, or after such discovery  
 6 should have been made by the exercise of reasonable diligence . . . .” 15 U.S.C. § 77. This means  
 7 Plaintiffs must file their claims “within one year of actual notice or inquiry notice” of an allegedly  
 8 untrue or misleading statement. *In re Stac Elec. Sec. Litig.*, 89 F.3d 1399, 1411 (9th Cir. 1996).  
 9 And, “where the underlying facts are undisputed, factually-based issues such as inquiry notice  
 10 may be decided as a matter of law.” *Meadows v. Pacif. Inland Sec. Corp.*, 36 F. Supp. 2d 1240,  
 11 1245 (S.D. Cal. 1999).

12 The Fund’s stated investment objective, disclosure of the compounding effect, and  
 13 historical return information contained in Annual Reports incorporated in the Prospectuses and  
 14 Registration Statements served as actual notice to Plaintiffs that, in fact, the Fund’s share price  
 15 and the price of the Long Treasury Bond can move in the same, rather than the opposite,  
 16 direction. To the extent that Plaintiffs argue this was not actual notice to them, several widely  
 17 available articles in the public domain should have led any reasonable investor to inquire and  
 18 “exercise due diligence in investigating . . . .” *Meadows*, 36 F. Supp. 2d at 1246. Yet, despite this  
 19 abundance of information, Plaintiffs make no allegations that they made any inquiry at all or even  
 20 recognized the need to do so. Appropriately, under the Securities Act, since they “[made] no  
 21 inquiry, the court imputes knowledge *as of the date the duty to inquire arose*.” *Freidus v. ING*  
 22 *Groep N.V.*, No. 09 Civ. 1049, 2010 WL 3554097, at \*6 (S.D.N.Y. Sept. 14, 2010) (emphasis  
 23 added). That is, the statute of limitations commenced no later than August 2008—19 months  
 24 before they filed suit.<sup>2</sup>

25  
 26 <sup>1</sup> *Trainer Wortham & Co. v. Betz*, 130 S. Ct. 2400 (2010). The Court of Appeals has since  
 27 remanded the case back to the District Court. *Betz v. Trainer Wortham & Co.*, 610 F.3d 1169 (9<sup>th</sup>  
 28 Cir.2010). Even if *Betz* had life, reliance on the case is, at best, misplaced, since *Betz* interpreted  
 the Exchange Act statute of limitations provisions for securities fraud and dealt with notice issues  
 particular to that statute, 28 U.S.C. § 1658(b).

<sup>2</sup> See *infra* note 5.

**A. Plaintiffs continue to misstate and misapprehend the Fund's objective.**

As explained in the Rydex Defendants' reply brief, the Registration Statements and Prospectuses unambiguously state that "the Fund's objective is to perform, *on a daily basis*, exactly opposite its benchmark, the Long Treasury Bond."<sup>3</sup> What is more, of the thirteen sentences comprising the page of the Prospectus that sets forth the investment objective, seven emphasize the "daily" nature of the Fund's objective. These oft-repeated statements would lead a reasonable investor to understand the "daily" nature of his or her investment, and, if that conflicted with his or her investment goals, to inquire about the Fund's performance if held for longer periods of time. Inexplicably, the self-proclaimed sophisticated Plaintiffs failed to make any such inquiry.

**B. Despite Plaintiffs' strained arguments to the contrary, the compounding effect was more than adequately disclosed.**

As explained in the Rydex Defendants' Reply Memorandum, the Registration Statements and Prospectuses were replete with language disclosing the compounding effect. Both the disclosure of the risk of "tracking error" on the page of the Prospectus setting forth the Fund's investment objective and the section entitled "Understanding Compounding & the Effects of Leverage" more than adequately disclosed that "because each Fund [except for certain Funds not including the Fund at issue here] is tracking the performance of its benchmark on a daily basis, mathematical compounding may prevent a Fund from correlating with the monthly, quarterly, annual or other period performance of its benchmark."<sup>4</sup>

**C. The Fund and its fee structure were designed to accommodate short-term trading.**

As more fully explained in the Rydex Defendants' Reply Memorandum, Plaintiffs' argument that the Fund's fee structure suggested that the Fund was intended to be a "long-term investment vehicle" is simply wrong. The Fund was structured to encourage, not discourage, short-term trading; after investors purchase shares in one Rydex fund and pay the required fees,

<sup>3</sup> 2007 Prospectus at 16 (Dkt. # 37-1, p. 19).

<sup>4</sup> 2007 Prospectus at 37 (Dkt. # 37-1, p. 40).

1 they are allowed to exchange their investment with other Rydex funds as frequently as they wish  
 2 at no cost. The Fund's unique fee structure, therefore, actually facilitated the short-term trading  
 3 opportunities that would flow from daily monitoring of the Fund's performance, consistent with  
 4 the Fund's investment objective.

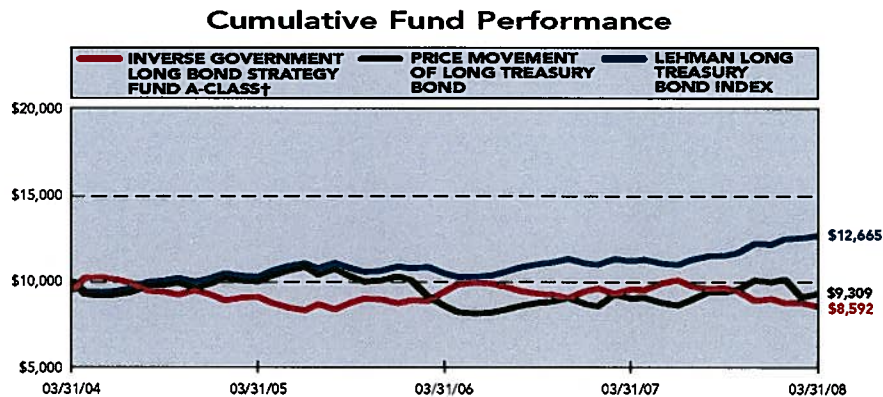
5 **D. Information disclosed in Annual Reports put Plaintiffs on actual notice of the**  
 6 **exact effect they claim was hidden from them.**

7 The crux of Plaintiffs' argument that their claims are not time-barred is that the  
 8 disclosures made to them concealed that the price movement of the Fund might not correlate with  
 9 the inverse of the price movement of the Long Treasury Bond over time. Opp. at 6-8. Yet, charts  
 10 contained in Annual Reports incorporated into the 2007 and 2008 Registration Statements and  
 11 Prospectuses unquestionably demonstrate that, over a period of time, the Fund's share price  
 12 moved in the same direction as, and not inversely to, the price of the Long Treasury Bond.<sup>5</sup> Thus,  
 13 Plaintiffs' argument that charts contained in the Annual Reports did not put them on inquiry  
 14 notice of the facts underlying their claims is misdirected, since the charts put Plaintiffs on actual  
 15 notice of the precise effect they now claim was unlawfully concealed.

16 Plaintiffs ask the Court to ignore the obvious simply because the charts, themselves, did  
 17 not discuss the *causes* of the result shown. Certainly, no "technical analysis [of the charts]  
 18 beyond the reach of a reasonable investor" was necessary to see the effect of which Plaintiffs now  
 19 complain. Opp. at 9. A reasonable investor could readily compare the percentage return for the  
 20 Fund to the percentage return for the Long Treasury Bond: -1.44% (Fund) and -3.30% (Bond)  
 21 average annual returns since inception, as stated in the 2007 Annual Report, and -3.72% (Fund)  
 22 and -1.77% (Bond) as stated in the 2008 Annual Report. There is no need "to decipher complex  
 23 raw data to understand" (Opp. at 9) that, when both numbers demonstrate a gain or, in this  
 24 instance, a loss over time, the Fund and the price of the Bond did not move in the opposite  
 25

26 <sup>5</sup> 2007 Annual Report at 33 (Dkt. # 37-4, p. 36); 2008 Annual Report at 33 (Dkt. # 37-5, p. 7).  
 27 The 2007 and 2008 Registration Statements and Prospectuses that incorporated the Annual  
 28 reports (*see* Independent Trustees' MTD at 3 n.5) were filed and available to investors on August  
 1, 2007 and August 1, 2008, respectively. Thus, Plaintiffs were on notice of the facts underlying  
 their claims at least 19 months before they filed suit.

direction.<sup>6</sup> If something more than numbers was needed, the Annual Reports also contained color graphs showing that, over time, the Fund had moved in the same direction as the Long Treasury Bond. For example, the 2008 Report contained the following color graph:



2008 Annual Report at 33 (Dkt. # 37-5, p. 7).<sup>7</sup> This occurred while the Fund was extremely successful in meeting its stated investment objective of tracking the inverse of the price changes of the Long Treasury Bond on a daily basis.

**E. Information in the public domain put Plaintiffs on notice of the facts underlying their claims, because the information was well-publicized and widely-available to a reasonably diligent investor.**

Plaintiffs argue that information widely-available on the Internet is insufficient to place them on inquiry notice of the facts underlying their claims. Yet, at the same time, Plaintiffs point to the “red flags” raised by FINRA “and others” to support their proposition that the Registration Statements and Prospectuses contained untrue statements or omissions. Opp. at 6-7.

Plaintiffs do not contend that they became aware of the FINRA alerts by actually having hard copies delivered to them, yet they appear to argue that only information presented in that fashion is sufficient to place investors on inquiry notice of the facts underlying their claims. To

<sup>6</sup> The Defendants do not contend, as Plaintiffs state, that the charts “put shareholders on notice that the Fund could not meet its investment objective if held for long periods of time.” Opp. at 8. The Fund’s investment objective had nothing to do with “long periods of time.” The Fund’s stated investment objective was to perform on a daily basis and that is what it did.

<sup>7</sup> For the convenience of the Court, attached as Exhibit A are excerpts of previously filed documents: “Performance Reports and Fund Profile” from the 2007 Annual Report at 32-33 (Dkt. # 37-4, pp. 35-36) and 2008 Annual Report at 32-33 (Dkt. # 37-5, pp. 6-7).

1 the contrary, “[a] reasonable investor is deemed to have knowledge of well publicized and widely  
 2 available information *in the public domain*.” *Meadows*, 36 F. Supp. 2d at 1246 (emphasis added).  
 3 For that reason, courts have long held that an investor is put on notice by print articles circulated  
 4 in regional and national newspapers or magazines, whether or not the investor actually subscribes  
 5 to the publications. *See Tello v. Dean Witter Reynolds, Inc.*, 494 F.3d 956, 971 n.13 (11th Cir.  
 6 2007) (knowledge of articles from publications such as *The Washington Post*, *USA Today*,  
 7 *Fortune*, and the *Atlanta Journal Constitution* is imputed to investors). The same logic applies to  
 8 articles that immediately pop up after typing a few basic terms into a search engine. As the  
 9 Seventh Circuit put it some 15 years ago, long before “Googling” had become commonplace:

10 In today’s society, with the advent of the “information  
 11 superhighway,” federal and state legislation and regulations, as well  
 12 as [other information], are easily accessed. A reasonable investor is  
 13 presumed to have information available in the public domain, and  
 therefore [Plaintiffs are] imputed with constructive knowledge of  
 this information.

14 *Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 610 (7th Cir. 1995); *see also Tello*, 494  
 15 F.3d at 971 (investors are imputed with knowledge of information that is “available with a simple  
 16 internet search”).

17 When Googled today, at least three of the articles quoted in the Independent Trustees’  
 18 Motion to Dismiss still appear on the first page of search results, despite the age of the articles  
 19 and using such basic terms as “inverse funds” and “rydex inverse fund.”<sup>8</sup> And, despite Plaintiffs’  
 20 protestations to the contrary, these articles were published on well-respected and heavily-  
 21 trafficked websites.<sup>9</sup> Accordingly, Plaintiffs cannot credibly contend that the information

22  
 23 <sup>8</sup> Many of the articles also appear on the first page of search results when Googling terms such  
 24 as “inverse funds tracking error,” “inverse etfs,” “inverse funds hold,” or “inverse fund  
 performance.” All of the Google searches referenced in this Memorandum were performed on  
 November 17, 2010.

25 <sup>9</sup> For instance, MarketWatch, published by Dow Jones & Co., is part of The Wall Street Digital  
 26 Network, which includes the website for The Wall Street Journal. It has 16 million visitors per  
 27 month—more than three times the 5 million per month Washington Post circulation that Plaintiffs  
 28 concede is widespread enough to trigger inquiry notice. *Opp.* at 10. *See*  
<http://www.marketwatch.com/companyinfo> (last visited Nov. 23, 2010). And, although Plaintiffs  
 point out that there are 70,000 average monthly *unique* visits to Morningstar.com, *Opp.* at 10,  
 they neglect also to point out that Morningstar.com has 6.1 million registered members. *See*  
[http://www.morningstar.com/aboutus/mediakit2010/audience\\_regmembers.html](http://www.morningstar.com/aboutus/mediakit2010/audience_regmembers.html) (last visited Nov.

1 contained in the articles was not “widely available information in the public domain.” *Meadows*,  
 2 36 F. Supp. 2d at 1246.

3 Further, although Plaintiffs apparently concede that the 2003 article was widely  
 4 available,<sup>10</sup> they argue that it was insufficient to place them on inquiry notice, because it “was a  
 5 background piece on ETF and mutual fund products that track indices and the companies that  
 6 offer them.” Opp. at 11. Plaintiffs are incorrect. The article is about inverse index funds and  
 7 discusses Rydex inverse index funds. In addition to warning that the Rydex inverse index funds  
 8 are “like surgical tools that are very, very sharp and need to be handled in a very precise fashion,  
 9 or you can nick yourself until you bleed to death,” the article paraphrases a Rydex portfolio  
 10 director as stating that “inverse funds are managed to maintain a certain relationship to the  
 11 benchmark every day. The cumulative impact of daily rebalancing usually causes a divergence  
 12 from the benchmark over a longer period of time.”<sup>11</sup> The 2003 article—which in plain English  
 13 explains that Rydex inverse funds, specifically, seek to perform on a daily basis and that the  
 14 compounding effect can cause the Fund to move in the same direction as its benchmark when  
 15 held for a period of time—places a reasonably diligent investor on notice of the facts underlying  
 16 Plaintiffs’ claims.

17 Because the articles were widely-available in the public domain before March 19, 2009,  
 18 Plaintiffs are deemed to have knowledge of the information contained in the articles, *Meadows*,  
 19 36 F. Supp. 2d at 1246, and their claims should be dismissed on limitations grounds.

20 **III. PLAINTIFFS DO NOT EVEN ATTEMPT TO EXPLAIN HOW THEY COULD**  
 21 **HAVE SUFFERED ANY COMPENSABLE DAMAGES UNDER SECTIONS 11**  
 22 **AND 12.**

23 The Independent Trustees’ MTD explained that Plaintiffs’ claims should also be  
 24 dismissed for the independent reason that Plaintiffs did not and could not have suffered any  
 25 compensable damages under the plain language of Sections 11(e) and 12(b).<sup>12</sup> Inexplicably,

26 23, 2010).

27 <sup>10</sup> Plaintiffs also incorrectly assume that the 2003 article is not available online. See  
<http://www.highbeam.com/doc/1G1-100957327.html> (last visited Nov. 22, 2010).

28 <sup>11</sup> Dkt. # 38-1, p. 4

<sup>12</sup> Plaintiffs’ contention that this argument is premature (*see* Opp. at 13) simply ignores well-  
 settled law holding that affirmative defenses should be decided at the Rule 12(b)(6) stage when

1 however, Plaintiffs' Opposition does not even mention the statutory language or its legislative  
 2 history. *See generally* Opp. at 12-15. Plaintiffs' failure to explain how they suffered  
 3 compensable losses alone warrants dismissal. Moreover, Plaintiffs' attempt now to rely on a  
 4 "materialization of the risk" theory also fails because they cannot explain how their losses could  
 5 have resulted from the materialization of a concealed risk.

6 **A. Plaintiffs' alleged losses cannot satisfy the statutory loss causation standard**  
 7 **governing claims under Sections 11 and 12(a)(2).**

8 As noted in the Independent Trustees' opening brief, Sections 11(e) and 12(b) define  
 9 compensable damages as the "depreciation in value" of a plaintiff's securities "resulting from"  
 10 the alleged misrepresentation or omission. *See* 15 U.S.C. § 77k(e); Independent Trustees' MTD at  
 11 6. Plaintiffs nowhere dispute that the shares of open-end mutual funds, including the Fund, are  
 12 priced according to a formula that turns on the value of the fund's net assets. *See* Independent  
 13 Trustees' MTD at 7. Nor do they argue that any "depreciation in value" of their Fund shares  
 14 "resulted from" the alleged misrepresentations or omissions about the risks of the Fund.<sup>13</sup> Nor is  
 15 there any way in which any decline in the value of Plaintiffs' Fund shares actually *could* have  
 16 been caused by the Fund's alleged misrepresentations or omissions about the mathematical  
 17 effects of compounding or the suitability of the Fund. In short, Plaintiffs offer literally no  
 18 explanation as to how their damages claims are consistent with the statute.

19 Rather than attempting to address the statutory language, Plaintiffs rely instead on *In re*  
 20 *Charles Schwab Corp. Sec. Litig.*, 257 F.R.D. 534 (N.D. Cal. 2009), which contains precisely the  
 21 same fundamental flaw as Plaintiffs' opposition: it fails to mention, much less analyze, the plain  
 22 language of the statute or its legislative history. Instead, *Schwab* relies exclusively on case law  
 23 interpreting the distinct and broader concept of "loss causation" under Section 10(b) of the  
 24

25 they are clear from the allegations pleaded in the complaint and judicially noticeable facts. *See,*  
 26 *e.g., Jones v. Bock*, 549 U.S. 199, 215 (2007); Independent Trustees' MTD at 12 n.6. That is  
 27 precisely the case here, and Plaintiffs' claims are, therefore, ripe for dismissal.

28 <sup>13</sup> Plaintiffs do not even dispute that their alleged losses "resulted from" the Fund's indisputably  
*successful* pursuit of its *disclosed* strategy of attempting to match the inverse of the daily price  
 movement of the Long Bond. *See* Compl. ¶31 (alleging that compounding is inherent in daily  
 inverse funds); Opp. to Rydex MTD at 12.

1 Exchange Act.<sup>14</sup> However, Section 10(b) precedents are not persuasive authority on this point for  
 2 at least three reasons:

3       *First*, Sections 11 and 12(a) of the Securities Act and Section 10(b) of the Exchange Act  
 4 have radically different language, which gives rise to equally different meanings. *Compare* 15  
 5 U.S.C. § 77k(e) *with* 15 U.S.C. § 78u-4(b)(4). Plaintiffs' argument ignores this critical fact and  
 6 wrongly assumes, without any reasoning or explanation, that the two different statutes have the  
 7 same meaning. While the *Schwab* court made the same mistake, the law is to the contrary, and  
 8 this Court should not perpetuate the error. *See, e.g., Akerman v. Oryx Commc'ns, Inc.*, 609 F.  
 9 Supp. 363, 369-70 (S.D.N.Y. 1984) *aff'd*, 810 F.2d 336 (2d Cir. 1987) (explaining that loss  
 10 causation under Section 11(e) is narrower than loss causation under the Exchange Act). *Second*,  
 11 the Exchange Act covers only *fraudulent* conduct, while the Securities Act is essentially a *strict*  
 12 *liability* statute. Therefore, it is completely appropriate that the Securities Act provides for a  
 13 narrower concept of causation than the Exchange Act. *See, e.g.,* Restatement (Second) of Torts §  
 14 435B, cmt. a; *Kimberlin v. DeLong*, 637 N.E.2d 121, 126 (Ind. 1994); *Kowal v. Hofher*, 436 A.2d  
 15 1, 3 (Conn. 1980). *Third*, the legislative history of the Securities Act makes clear that Congress  
 16 passed Sections 11 and 12 (and chose not to include a reliance element in either claim) on the  
 17 assumption that misrepresentations in a registration statement or prospectus *would* affect the price  
 18 of the security through secondary market trading. *See* Independent Trustees' MTD at 9-10. This  
 19 rationale is not applicable in the mutual fund context, because, as even Plaintiffs do not dispute,  
 20 any misrepresentations or omissions about the risks of the Fund could not have affected the price  
 21 of the Fund's shares.

22       Simply put, there is no reason to distort the plain language of Section 11(e) of the  
 23

24 <sup>14</sup> *In re Evergreen Ultra Short Opportunities Fund Sec. Litig.*, 705 F. Supp. 2d 86 (D. Mass.  
 25 2010) makes the same error, following *Schwab* in equating these different causation provisions  
 26 without ever reconciling the court's ruling with the language of the governing statute. *See id.* at  
 27 94-95. Plaintiffs also cite *In re Mut. Funds Inv. Litig.*, 590 F. Supp. 2d 741 (D. Md. 2008), but  
 28 that case is not on point because it addresses the broader loss causation provision of the Exchange  
 Act. The Exchange Act's broader loss causation standard also renders hollow Plaintiffs' claimed  
 fears of mutual-fund immunity for misrepresentations or omissions. *See, e.g., Castillo v. Dean*  
*Witter Discover & Co.*, No. 97 Civ. 1272, 1998 WL 342050, at \*6 (S.D.N.Y. June 25, 1998);  
*Hanley v. First Investors Corp.*, 793 F. Supp. 719, 720 (E.D. Tex. 1992).

1 Securities Act to create a claim for damages for investors who may not have read, let alone relied  
 2 upon, a prospectus that had literally no impact on the value of their investment. Certainly,  
 3 Congress has never expressed any intent to create such a novel claim.

4 **B. Even if the Court applies the erroneous “materialization of the risk”**  
 5 **causation standard, Plaintiffs’ claims still fail.**

6 Even if the *Schwab* court’s reasoning were applied here, Plaintiffs cannot identify a  
 7 concealed risk that materialized and caused their losses. The Prospectuses explained the  
 8 implications of the Fund’s investment objective this way:

9 If the Fund meets its objective, the value of the Fund’s shares will  
 10 increase on a daily basis when the price of the Long Treasury Bond  
 11 decreases. When the price of the Long Treasury Bond increases,  
 12 however, the value of the Fund’s shares should decrease on a daily  
 basis by an inversely proportionate amount (*e.g.*, if the price of the  
 Long Treasury Bond increases by 2%, the value of the Fund’s  
 shares should go down by 2% on that day).

13 2007 Prosp. at 16 (Dkt. # 37-1, p. 19). Plaintiffs do not dispute that this is *exactly what*  
 14 *happened*. Therefore, Plaintiffs cannot claim that there were any concealed risks that  
 15 materialized and caused the Fund to produce returns that differed from those that the Fund told  
 16 investors it was seeking to achieve.

17 This failing explains why Plaintiffs have now altered their theories to focus almost  
 18 exclusively on a vague “suitability” claim, arguing that the prospectuses were misleading because  
 19 they failed to state expressly that “the Fund was suitable only for short-term investors who  
 20 actively manage their portfolios on a daily basis[.]” Opp. to Rydex MTD at 17.

21 This omission theory cannot give rise to compensable damages under the statute either.  
 22 First, Plaintiffs make no attempt to explain how a suitability omission can amount to anything  
 23 more than transaction causation. *See* Independent Trustees’ MTD at 9; *see also In re Oracle*  
 24 *Corp. Sec. Litig.*, \_\_ F.3d \_\_, No. 09-16502, 2010 WL 4608794, at \*10-11 (9th Cir. Nov. 16,  
 25 2010) (holding that, even under the Exchange Act, loss causation requires a showing that “the  
 26 market” reacted to the revelation of the misleading statement and bid the price of the security up  
 27 or down). Second, suitability, by definition, focuses on the characteristics of potential investors;  
 28

1 it has no impact on the fund's operation or performance and certainly no impact on the value of  
2 the fund's shares. Thus, even under *Schwab*'s erroneous reasoning, Plaintiffs' claims fail.

3 Whether Plaintiffs can use the "materialization of an undisclosed risk" theory to  
4 circumvent the plain language of Sections 11 and 12 and, if so, whether Plaintiffs' allegations  
5 could satisfy that theory, are pure questions of law. The answer to both questions does not turn  
6 on whose burden it is to prove or disprove loss causation; to the contrary, the conclusion is  
7 apparent from the face of the Complaint and the plain text of Sections 11 and 12. Plaintiffs have  
8 alleged claims for which the requisite causation will never be established. Accordingly, the  
9 Independent Trustees submit that the Court should dismiss Plaintiffs' claims now.

#### 10 **IV. PLAINTIFFS FAIL TO STATE A PLAUSIBLE CLAIM FOR CONTROL-** 11 **PERSON LIABILITY AGAINST THE INDEPENDENT TRUSTEES.**

12 Plaintiffs try to confuse the issue by suggesting that the Independent Trustees have argued  
13 for "heightened pleading" and "pleading with particularity" when pointing out the post-*Twombly*  
14 and *Iqbal* requirement that Plaintiffs must state facts demonstrating a plausible claim for relief.  
15 Opp. at 16. Plaintiffs cannot seriously dispute that, post-*Twombly* and *Iqbal*, "plaintiffs face a  
16 higher burden of pleading facts" than they did before. *al-Kidd v. Ashcroft*, 580 F.3d 949, 977 (9th  
17 Cir. 2009). For this reason, alone, the pre-*Twombly* and *Iqbal* cases on which Plaintiffs rely to  
18 urge the adequacy of their allegations of control person liability do not have the same persuasive  
19 authority or warrant the same level of attention as those decided after.<sup>15</sup>

20 As noted in the Independent Trustees' Motion to Dismiss, and a point Plaintiffs do not  
21 dispute, only one case within this Circuit has provided a meaningful discussion applying  
22 *Twombly* and *Iqbal* to control-person liability claims: *Teamsters Local 617 Pension and Welfare*  
23 *Funds v. Apollo Grp.*, 690 F. Supp. 2d 959 (D. Ariz. 2010) ("*Apollo*"). According to the Court in  
24 *Apollo*, post-*Twombly* and *Iqbal*, Plaintiffs must include "allegations of the [alleged control  
25 persons'] participation in the day-to-day affairs of the corporation and [their] power to control

26 <sup>15</sup> See Opp. at 18 (citing *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433 (S.D.N.Y. 2005), *N.J. v.*  
27 *Sprint Corp.*, 314 F. Supp. 2d 1119 (D. Kan. 2004), *In re Enron Corp. Sec., Deriv. & "ERISA"*  
28 *Litig.*, 258 F. Supp. 2d 576 (S.D. Tex. 2003), and *In re Livent, Inc. Noteholders Sec. Litig.*, 151 F.  
Supp. 2d 371 (S.D.N.Y. 2001) for the now outdated proposition that courts presume control  
where an outside director is alleged only to have signed the filing).

1 corporate actions.” *Id.* at 971 (citation omitted). The complaint at issue in *Apollo* contained  
 2 detailed allegations regarding directors’ service on committees and the duties and responsibilities  
 3 of those committees. *Id.* at 978-79. But, the Court still dismissed the claim, because the  
 4 Complaint failed to allege each director’s responsibilities as an individual outside director. *Id.* at  
 5 978; *see also Reese v. Malone*, No. C-08-1008, 2009 WL 506820, at \*8 (W.D. Wash. Feb. 27,  
 6 2009) (similarly holding that allegations regarding a director’s position and committee  
 7 membership and the general duties of the committee are insufficient to state a claim for control  
 8 person liability).

9 Thus, even if allegations made for the first time in a brief opposing a motion to dismiss  
 10 could cure the deficiencies of a complaint, the newly-added allegations here still would not save  
 11 Plaintiffs’ claim.<sup>16</sup> As *Apollo* and *Reese* establish, allegations amounting to no more than an  
 12 outside director’s committee membership and the general duties and responsibilities of the  
 13 committee, itself, do not state a claim for control person liability. Here, the complaint must  
 14 include allegations regarding each Independent Trustee’s responsibilities as an Independent  
 15 Trustee. Significantly, while the Board as a whole has the authority to oversee the management  
 16 of the Trust, no single Independent Trustee has the power to direct the management and policies  
 17 of the Trust. Plaintiffs’ conclusory suggestion otherwise is akin to suggesting that since  
 18 stockholders as a whole have the power to elect the Board and, thus, influence management, each  
 19 individual stockholder, alone, has that same power. Since there is no allegation, nor could there  
 20 be, that any one of the Independent Trustees, individually, has the power to control the Trust,  
 21 there are no facts to find. Whether Plaintiffs have failed to state a claim for control person  
 22 liability is, therefore, a question of law. For these reasons, Plaintiffs have failed to state a claim  
 23 for control by the Independent Trustees, and their Section 15 claim should be dismissed.<sup>17</sup>

24  
 25 <sup>16</sup> “Taking judicial notice of [information outside the complaint] cannot be used to cure  
 26 deficiencies in the Complaint . . . .” *Cohea v. Cal. Dep’t of Corr. & Rehab.*, No. CV 1-07-00469-  
 27 SRB, 2009 WL 3246850, at \*2 n.3 (E.D. Cal. Oct. 7, 2009) (judicial notice of earlier-filed case,  
 28 and plaintiff’s post-hoc allegation based on notice of the case did not cure plaintiff’s failure to  
 include that allegation in the actual complaint); *see also Watts v. Enhanced Recovery Corp.*, No.  
 10-02606-LHK, 2010 WL 4117452, at \*3 (N.D. Cal. Oct. 19, 2010) (motion to dismiss  
 opposition may not rely on facts not pleaded in the complaint).

<sup>17</sup> Plaintiffs appear to concede that the Complaint contains insufficient allegations by ending their

**V. PLAINTIFFS CANNOT ALLEGE THE REQUISITE PERSONAL INJURY TO ESTABLISH STANDING TO BRING ALL CLAIMS.**

“In a class action, the lead plaintiffs must show that they personally have been injured, ‘not that injury has been suffered by other, unidentified members of the class to which they belong and which they purport to represent.’” *Me. State Ret. Sys. v. Countrywide Fin. Corp.*, \_\_ F. Supp. 2d \_\_, 2010 WL 4452571 at \*3 (C.D. Cal. Nov. 4, 2010) (citing *Warth v. Seldin*, 422 U.S. 490, 502, 95 S. Ct. 2197 (1975)).

There is no dispute that Plaintiffs purchased only the Fund’s A class shares and only pursuant to the 2007 and 2008 Registration Statements and Prospectuses. Given Plaintiffs’ lack of personal injury from other share classes or pursuant to the 2009 Registration Statement and Prospectus, they cannot demonstrate standing to sue for injuries they allege other, unidentified members of the class have suffered.

Plaintiffs contend that they have standing to represent unidentified members of the class because “their injuries are traceable to the actions of Defendants who made those misrepresentations and omissions.” Opp. at 19. But all of Plaintiffs’ purchases predate the 2009 documents. Common sense dictates that Plaintiffs’ personal injuries cannot be traceable to alleged misrepresentations or omissions that supposedly occurred after those injuries were suffered. By that logic, Plaintiffs could trace current personal injuries to statements that Defendants have yet to make. Further, by law, “[a] registration statement shall be deemed effective only as to securities specified therein as proposed to be offered.” 15 U.S.C. § 77f(a). Plaintiffs’ injuries, as alleged, are limited to the 2007 and 2008 documents and are not traceable to future events.<sup>18</sup>

Nor do the cases Plaintiffs cite support their position. *Hicks v. Morgan Stanley & Co.* expressly examined the typicality and adequacy-of-representation of the named plaintiffs during a

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argument with the following statement: “. . . even if Plaintiffs have inadequately alleged that the Trustee Defendants were ‘control persons’ Plaintiffs’ Section 15 claim should not be dismissed, because such a determination is premature.” Opp. at 18 (emphasis added). In fact, that is precisely the purpose of a 12(b)(6) motion to dismiss—to dispose of claims, like Plaintiffs’, that are not adequately pled in the complaint.

<sup>18</sup> Similarly, the other, unidentified members of the class who purchased securities pursuant only to the 2009 documents cannot trace injuries to the 2007 or 2008 documents.

1 Rule 23 class-certification motion. No. 01 Civ. 10071(HB), 2003 WL 21672085, at \*2-4  
 2 (S.D.N.Y. July 16, 2003). However, class-representation elements are irrelevant to the issue of  
 3 standing. *Lewis v. Casey*, 518 U.S. 343, 357 (1996) (“That a suit may be a class action . . . adds  
 4 nothing to the question of standing, for even named plaintiffs who represent a class must allege  
 5 that they personally have been injured, not that injury has been suffered by other, unidentified  
 6 members of the class . . .”); *see also LaDuke v. Nelson*, 762 F. 2d 1318, 1325 (9th Cir. 1985)  
 7 (standing “is a jurisdictional element that must be satisfied prior to class certification”).<sup>19</sup>

8 At the Rule 12(b) stage, “courts considering class action complaints under Section 11  
 9 have overwhelmingly held that the lead plaintiffs named in the complaint lack standing to  
 10 challenge any offering through which no lead plaintiff actually purchased a security.” *In re Wells*  
 11 *Fargo Mortgage-Backed Sec. Certificates Litig.*, 712 F. Supp. 2d 958, 964 (N.D. Cal. 2010).<sup>20</sup>  
 12 That is the appropriate result here, as well, where Plaintiffs have not suffered personal injuries  
 13 traceable to the 2009 documents or traceable to the 2007 or 2008 documents for the Advisor,  
 14 Investor, or C class shares; Plaintiffs, therefore, lack standing to bring these claims.

## 15 VI. CONCLUSION

16 For the foregoing reasons, the Independent Trustees respectfully request that the Court  
 17 dismiss Plaintiffs’ Complaint.

18 Dated: November 30, 2010

SCHIFF HARDIN LLP

19 By: \_\_\_\_\_ /S/  
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25 <sup>19</sup> Plaintiffs also cite *In re Juniper Networks, Inc. Sec. Litig.*, which suffers the same short-coming; it  
 26 pertains to a Rule 23 class-certification motion, not the standing issues posed by a motion to dismiss.  
 27 264 F.R.D. 584 (N.D. Cal. 2009)

28 <sup>20</sup> The Court in *Wells Fargo* cites to the following cases for this proposition: *Plumbers’ Union Local*  
*No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 658 F. Supp. 2d 299, 303 (D. Mass. 2009); *In*  
*re Wash. Mut., Inc. Sec., Derivative & ERISA Litig.*, 259 F.R.D. 490 (W.D. Wash. 2009); *In re Salomon*  
*Smith Barney Mut. Fund Fees Litig.*, 441 F. Supp. 2d 579, 607 (S.D.N.Y. 2006); *On ex rel. Ong IRA v.*  
*Sears, Roebuck & Co.*, 388 F. Supp. 2d 871, 890-891 (N.D. Ill. 2004).